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McRaeIndustries

ANNUAL REPORT

Corporate Profile

McRae Industries, Inc. was founded in 1959 as a manufacturer and distributor of children's shoes. Today, McRae Industries is involved in manufacturing, sales and distribution of high quality, reasonably priced boot products targeted to the western/lifestyle and work boot markets. In addition, we continue to take pride in manufacturing military combat boots for the U. S. Government. The company also operates other smaller businesses.

McRae Industries, Inc. corporate headquarters is located in Mount Gilead, North Carolina.

Selected Consolidated Financial Data

The following Selected Consolidated Financial Data of the Company presented below for each of the five years in the periods indicated has been derived from our audited and consolidated financial statements.

FISCAL YEARS ENDED	7/28/18	7/29/17	7/30/16	8/1/15	8/2/14
(In thousands, except per share data)					
INCOME STATEMENT DATA:					
Net revenues	$ 73,892	$ 104,316	$ 108,758	$ 108,673	$ 103,629
Net earnings (loss)	2,190	5,083	4,692	6,641	7,548
Net earnings per common share					
Diluted Earnings per share[a]:					
Class A	0.91	2.11	1.93	2.73	3.11
Class B	NA	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	$ 80,364	$ 81,641	$ 80,839	$ 78,344	$ 71,186
Long-term liabilities	621	2,263	2,288	1,513	1,536
Working capital	55,435	56,542	52,753	51,251	51,181
Shareholders' equity	74,989	74,201	70,860	67,828	62,450
Weighted average number of common shares outstanding:					
Class A	2,018,701	2,024,470	2,035,906	2,038,645	2,038,469
Class B	378,020	385,830	389,271	391,879	392,055
Weighted average number of common shares outstanding[b]:	2,396,721	2,410,300	2,425,177	2,430,524	2,430,524
Cash dividends per Class A common share:	$ 0.52	$ 0.52	$ 0.52	$ 0.52	$ 0.48
Cash dividends per Class B common share:	$ 0.52	$ 0.52	$ 0.52	$ 0.52	$ 0.48
Special Cash dividend per Class A and Class B common share	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

(a) This calculation uses the if-converted method which assumes all Class B Common Stock is converted into Class A Common Stock; thus, there are no holders of Class B Common Stock to participate in undistributed earnings. See Note 1 to the consolidated financial statements included in this report.

(b) Includes both Class A and Class B Common Stock.

Letter To Shareholders

Dear Valued Shareholders,

I am pleased to present the McRae Industries 2018 Annual Report to you.

For fiscal 2018, net revenues decreased from $104.3 million for fiscal 2017 to $73.9 million for fiscal 2018. The decrease in sales was primarily the result of decreases in our United States Government military contract business, decreases in our John Deere adult and children business, as well as softness in some sectors of our western business. Net income decreased from $5.1 million in fiscal 2017 to $2.2 million in fiscal 2018. The profitability of our western/lifestyle segment and western work boots remained about the same between fiscal 2017 and fiscal 2018. However, the military business operated at a loss due to issues described below that negatively impacted total earnings for the company.

Our western/lifestyle boot segment, which includes western wear, ladies fashion, and children footwear products under the Dan Post, Dingo, El Dorado, Laredo, and John Deere brand names, experienced a decrease in revenue of 5.6% from $48.8 million in fiscal 2017 to $46.1 million dollars in fiscal 2018. Gross margins for the western/lifestyle segment increased from 34.2% for fiscal 2017 to 34.5% for fiscal 2018. The sales decrease was primarily made up of Dan Post higher priced fashion boots, John Deere children boots, and Laredo men's boots. These sale decreases were partially offset by increases in our Laredo Cowboy Approved products and our El Dorado brand of premium men's boots. The Laredo men's boot business decrease was partly attributable to a large one off order from one of our customer's in fiscal 2017, which was not repeated in fiscal 2018. Delivery problems also developed toward the end of the third quarter, as our primary Laredo boot supplier moved into a new manufacturing facility and suffered production delays as a result. While we expect to continue to see delivery issues until the early part of calendar 2019, we are working with current and new vendors to alleviate this issue as soon as possible. Management feels that these delivery problems had a substantial impact on Laredo sales for fiscal 2018.

In our western/lifestyle segment, we are hopeful that fiscal 2019 will see growth in our Dan Post, Laredo, and Dingo brands; however, we anticipate that some of the programs we are putting in place will take time to produce results in this generally soft market for western boots. We are developing more products to complement our Laredo Cowboy Approved and Dan Post Cowboy Certified brands including introducing a line of Cowboy Approved work boots and Cowboy Certified work boots. For our Dingo brand, we are moving the direction into more lifestyle designs and have hired designers and a sales team to advance this effort. We are also developing a line of Dan Post ladies value boots, which we think will meet the market trends in this area. In addition, we have negotiated lower prices for our exotic leathers which should enable us to increase sales in this vital segment of our business. In fiscal 2018, we launched our new e-commerce website and will be substantially increasing our digital advertising and marketing dollars in fiscal 2019 as we continue to build our family of Dan Post Boot Company customers.

Net revenues for our work boot segment, which includes Dan Post, Laredo, John Deere, and McRae Industrial work boots, along with our military boots, decreased by 49.6% from $54.4 million in fiscal 2017 to $27.4 million in fiscal 2018. The military boot sales were the vast majority of this decrease as they went from $45.6 million in fiscal 2017 to $20.2 million in fiscal 2018. Gross margins in our work boot brands increased slightly from 34.7% in fiscal 2017 to 36.2% in fiscal 2018. Gross margins on our military boots decreased from 12.1% in fiscal 2017 to -0.1% in 2018 because of manufacturing inefficiencies as a result of the lower volume of production.

In our military business, fiscal 2018 proved to be a difficult year primarily because of the United States Government's over inventoried position on the hot weather Army boots and not awarding the temperate weather boot contract until four months after McRae had completed its obligation on the expiring contract.

While we received awards on both the hot weather and temperate weather Army boots, the delivery order quantities were below those projected by the Government and first order delivery dates were extended. These issues resulted in layoffs of trained employees until new orders were obtained. In August 2018, the Government asked us to increase our production on the temperate weather combat boot because the Air Force was changing the color of their boot from sage to coyote and in doing so was adopting the Army temperate weather boot. While we expect this to almost double our current temperate weather boot production, we will be working toward this quantity over the next seven to eight months. The Government expects this volume to last for one to two years.

The hot weather Army boot contract award we received from the Defense Logistics Agency Troop Support in November 2017 was for a maximum $40,434,006 firm fixed price, indefinite delivery/indefinite quantity contract. This is a one year base contract with four one year option periods. The temperate weather Army boot contract award we received from the Defense Logistics Agency Troop Support in March 2018 was for a maximum $75,476,836 firm fixed price, indefinite delivery/indefinite quantity contract. This is a one year base contract with four one year option periods. In August 2018, we also received a contract award for temperate weather black Army boots from the Defense Logistics Agency Troop Support for a maximum $2,872,500 firm fixed price, indefinite delivery/indefinite quantity contract. This award has a three year base ordering period. Our current contract for Marine hot weather boots will be completed in March 2019. We have placed a bid on the new Marine hot weather boot solicitation which should be awarded in the January/February 2019 time frame. We also have a small contract for Army flame resistant boots which will end in January 2020. We continue to develop a commercial military boot program and while the sales were flat compared to fiscal 2017, we did develop several new commercial products that began shipping in fiscal 2018 and initiated development on others that should ship the coming year.

In fiscal 2018, we continued to invest in equipment that would enable us to be more efficient as we purchased Lectra fabric and leather cutting machines. This will save the company money on our fabric and leather, as well as cutting dies. We also began programs to move more of our stitching operations to computerized stitching machines, which will reduce the amount of training time for new employees. In fiscal 2019, our military boot business success will be determined by the success we have in procuring more orders from the United States Government, foreign contracts we are pursuing, our manufacturing efficiency as we hire and train new workers, and our success in our commercial military boot program.

Despite the decline in earnings, our cash position has remained relatively consistent year over year. Operations provided approximately $4.1 million in cash for 2018, which was offset by $3.2 million in investing activities and $1.4 million in financing activities. After reviewing our financial results for the year, the Board decided to use our excess cash to declare a special dividend in August 2018. Excess cash will also be used for the initiatives discussed above and management will continue to monitor the business to determine the best use of our capital.

On behalf of the Board of Directors, we thank you for your continued good will and support.

Sincerely,

D. Gary McRae

D. Gary McRae
President

FINANCIAL STATEMENTS
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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Shareholders of
McRae Industries, Inc. and Subsidiaries

We have audited the accompanying consolidated financial statements of **McRae Industries, Inc.** (a Delaware corporation) **and Subsidiaries**, which comprise the consolidated balance sheets as of July 28, 2018 and July 29, 2017, and the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended July 28, 2018, and the related notes to the financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

Grant Thornton

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of McRae Industries, Inc. and Subsidiaries as of July 28, 2018 and July 29, 2017, and the results of their operations and their cash flows for each of the three years in the period ended July 28, 2018, in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
October 30, 2018

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	July 28, 2018	July 29, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$27,605	$28,057
Short term securities	2,211	505
Accounts and notes receivable, less allowances of $1,221 and $1,192, respectively	10,665	12,331
Inventories, net	18,427	18,273
Income tax receivable	1,127	329
Prepaid expenses and other current assets	154	550
Deferred tax assets	–	1,674
Total current assets	60,189	61,719
Property and equipment, net	7,375	7,391
Other assets:		
Deposits	14	14
Long term securities	3,899	3,804
Real estate held for investment	3,775	3,601
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Total other assets	12,800	12,531
Total assets	$80,364	$81,641

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	**July 28, 2018**	**July 29, 2017**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,968	$2,510
Accrued employee benefits	423	1,144
Accrued payroll and payroll taxes	630	809
Other	733	714
Total current liabilities	4,754	5,177
Deferred tax liabilities	621	2,263
Total liabilities	5,375	7,440
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 2,019,974 and 2,014,842 shares, respectively	2,020	2,015
Class B, $1 par value; authorized 2,500,000 shares; issued and outstanding, 374,272 and 383,254 shares, respectively	375	384
Unrealized losses on investments, net of tax	(28)	(5)
Retained earnings	72,622	71,807
Total shareholders' equity	74,989	74,201
Total liabilities and shareholders' equity	$80,364	$81,641

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)

For Years Ended	**July 28, 2018**	**July 29, 2017**	**July 30, 2016**
Net revenues	$73,892	$104,316	$108,758
Cost of revenues	55,182	78,739	81,837
Gross profit	18,710	25,577	26,921
Selling, general and administrative expenses	16,431	17,755	19,782
Operating profit	2,279	7,822	7,139
Other income	443	357	366
Interest expense	(1)	-	-
Earnings before income taxes	2,721	8,179	7,505
Provision for income taxes	531	3,096	2,813
Net earnings	$2,190	$5,083	$4,692
Other comprehensive income, net of tax:			
Unrealized gains (losses) on investments	(23)	54	(59)
Total comprehensive income	$2,167	$5,137	$4,633
Earnings per common share:			
Earnings per common share:			
Diluted earnings per share:			
Class A	0.91	2.11	1.93
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	2,018,701	2,024,470	2,035,906
Class B	378,020	385,830	389,271
Total	2,396,721	2,410,300	2,425,177

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
McRae Industries, Inc and Subsidiaries

(Dollars in thousands)	Common Stock, $1 par value				Accumulated Other	
	Class A		Class B		Comprehensive	Retained
	Shares	Amount	Shares	Amount	Income (Loss)	Earnings
Balance, August 1, 2015	2,039,335	$2,040	391,189	$391	$ -	$65,397
Purchase of ESOP distribution shares	(9,164)	(9)	(3,073)	(3)		(330)
Unrealized losses on investments, net of tax					(59)	
Conversion of Class B to Class A Stock	487	-	(487)	-		-
Cash Dividend ($.52 per Class A common stock)						(1,057)
Cash Dividend ($.52 per Class B common stock)						(202)
Net earnings						4,692
Balance, July 30, 2016	2,030,658	$2,031	387,629	$388	($59)	$68,500
Purchase of ESOP distribution shares	(16,346)	(16)	(3,845)	(4)		(525)
Unrealized losses on investments, net of tax					54	
Conversion of Class B to Class A Stock	530	-	(530)	-		-
Cash Dividend ($.52 per Class A common stock)						(1,051)
Cash Dividend ($.52 per Class B common stock)						(200)
Net earnings						5,083
Balance, July 29, 2017	2,014,842	$2,015	383,254	$384	($5)	$71,807
Stock Buyback	(3,116)	(3)	(734)	(1)		(129)
Unrealized losses on investments, net of tax					(23)	
Conversion of Class B to Class A Stock	8,248	8	(8,248)	(8)		-
Cash Dividend ($.52 per Class A common stock)						(1,050)
Cash Dividend ($.52 per Class B common stock)						(196)
Net earnings						2,190
Balance, July 28, 2018	2,019,974	$2,020	374,272	$375	($28)	$72,622

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
McRae Industries, Inc. and Subsidiaries

(In thousands)

For Years Ended	July 28, 2018	July 29, 2017	July 30, 2016
Cash Flows from Operating Activities:			
Net earnings	$2,190	$5,083	$4,692
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	1,234	1,211	907
(Gain) loss on sale of assets	-	(2)	(6)
(Gain) loss on sale of land	(37)	-	-
Loss on sale of securities	2	6	62
Deferred income taxes	32	398	951
Changes in operating assets and liabilities:			
Accounts receivable, net	1,666	377	2,928
Inventories	(154)	9,671	(2,187)
Prepaid expenses and other assets	396	(117)	99
Accounts payable	458	(2,186)	(903)
Accrued employee benefits	(721)	54	(537)
Accrued payroll and payroll taxes	(179)	(398)	(18)
Income tax receivable/payable	(798)	726	(933)
Other	20	16	146
Net cash provided by operating activities	**4,109**	**14,839**	**5,201**
Cash Flows from Investing Activities:			
Proceeds from sale of assets	-	13	15
Proceeds from sale of land	46	-	-
Purchase of land for investment	(180)	-	(17)
Capital expenditures	(1,217)	(465)	(3,237)
Proceeds from sale of securities	1,194	833	484
Purchase of securities	(3,025)	(1,040)	(609)
Net cash used in investing activities	**(3,182)**	**(659)**	**(3,364)**
Cash Flows from Financing Activities:			
Purchase of common stock	(133)	(545)	(342)
Dividends paid	(1,246)	(1,251)	(1,259)
Net cash used in financing activities	**(1,379)**	**(1,796)**	**(1,601)**
Net Increase (Decrease) in Cash and Cash equivalents	(452)	12,384	236
Cash and Cash Equivalents at Beginning of Year	28,057	15,673	15,437
Cash and Cash Equivalents at End of Year	**$27,605**	**$28,057**	**$15,673**

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
McRae Industries, Inc. and Subsidiaries
As of and for the Years Ended July 28, 2018, July 29, 2017, and July 30, 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

McRae Industries, Inc., (the “Company”, which may be referred to as “we”, “us” or “our”), is a Delaware corporation organized in 1983 and is the successor to a North Carolina corporation organized in 1959. Our principal lines of business are: manufacturing and selling military combat boots and importing and selling western and work boots.

Principles of Consolidation

The consolidated financial statements include the accounts of all of the Company’s wholly owned subsidiaries and other businesses over which we exercise significant control. All significant intercompany transactions and balances have been eliminated in consolidation.

Total assets and net revenues for each of our main business units are as follows:

	(In thousands)		
	2018	**2017**	**2016**
Total Assets:			
Western/Work Boots	$ 27,833	$ 30,443	$ 35,131
Military Boots	11,286	12,037	17,698
Other	39	41	50

	(In thousands)		
	2018	**2017**	**2016**
Total Net Revenues:			
Western/Work Boots	$ 53,479	$ 58,312	$ 68,912
Military Boots	20,180	45,621	39,628
Other	233	383	218

Use of Estimates

The timely preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates. The economic price adjustment related to our military combat boot contract is subject to certain price variations for leather.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits with banks and certificates of deposit purchased with an original maturity date of three months or less.

Accounts Receivable

Accounts receivable are stated at amounts expected to be collected from outstanding balances. Probable uncollectible accounts are reserved for by a charge to earnings and a credit to the allowance for doubtful accounts based on the assessment of the current status of individual accounts. Balances that are still outstanding after using reasonable collection efforts are written off through a charge to the allowance and a credit to accounts receivable. The Company performs on-going credit evaluations of its customers' financial condition and establishes an allowance for losses on trade receivables based upon factors surrounding the credit risk of specific customers, historical trends, and other information.

Our western and work boot business records an allowance for sales returns which is calculated by applying historical return data to sales subject to potential returns. The allowance for sales returns, which is different from the allowance noted in the preceding paragraph, is included as a component of the allowance presented on the balance sheet. This component totaled approximately $505,000 and $575,000 for fiscal 2018 and fiscal 2017, respectively.

Inventories

Inventories are stated at the lower of cost or market value using the last-in, first-out (LIFO) method for military boots and using the first-in, first-out (FIFO) method for all other inventories. We regularly review our FIFO basis inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast and demand requirements for the next twelve months. Actual demand and market conditions may be different from those projected by our management primarily as a result of fashion cycles and trends and the overall financial condition of competitors in the western and work boot business. A one percentage point error in our inventory allowances would approximate $3,200 and $4,200 for the fiscal years ended July 28, 2018, and July 29, 2017, respectively.

Marketable Securities

The Company determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date. Debt securities are classified as held to maturity when the Company has the positive intent and ability to hold securities to their maturity. Held-to-maturity securities are recorded as either short term or long term on the consolidated balance sheets, based on their contractual maturity date and are stated at amortized cost. Investments in debt or equity securities that are not classified as held-to-maturity are carried at fair value and classified as available-for-sale. Realized and unrealized gains and losses on available-for-sale securities are included in other comprehensive income. Refer to Note 10 for additional information related to the Company's available-for-sale securities.

Long-Lived Assets and Other Intangibles

The Company reviews long-lived assets with estimable useful lives for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell.

The Company tests identifiable intangible assets with an indefinite life for impairment annually. Furthermore, such assets are required to be tested for impairment on an interim basis if an event or circumstance indicates that it is more likely than not an impairment loss has been incurred. An impairment loss shall be recognized to the extent that the carrying amount of such assets exceeds its implied fair value. Impairment losses shall be recognized in operations. The Company's valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and projections of future operating performance. If these assumptions differ materially from future results, the Company may record impairment charges in the future. Based on its most recent analysis, the Company believes that no impairment exists as of July 28, 2018 and July 29, 2017, respectively.

Revenue Recognition

Sales of the Company are recognized as revenues when goods are shipped and title passes to the buyer. Our military boot sales to the U.S. Government under our current contracts are recognized as revenues when the goods are received at their designated depot.

Income Taxes

The Company accounts for income taxes under the asset and liability method. Federal and state income taxes are computed at current tax rates, less tax credits. Taxes are adjusted both for items that do not have tax consequences and for the cumulative effect of any changes in tax rates from those previously used to determine deferred tax assets or liabilities. Tax provisions include amounts that are currently payable, plus changes in deferred tax assets and liabilities that arise because of temporary differences between the time when items of income and expense are recognized for financial reporting and income tax purposes. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not such assets will be realized.

The Company adopted ASU No. 2015-17, *"Balance Sheet Classification of Deferred Taxes (Topic 740)"* (ASC 2015-17), effective for the Company as of July 30, 2017 (first day of fiscal 2018). This update requires that deferred tax liabilities and assets, along with corresponding valuation allowances, be classified as noncurrent on the balance sheet. The Company elected to apply a prospective adoption approach such that the balances of deferred tax liabilities and assets, along with the corresponding valuation allowances, at July 29, 2017 have not been recast.

The Company follows the applicable authoritative guidance related to accounting for uncertainty in income tax reporting. This guidance clarifies the accounting for uncertainty in income taxes recognized in the Company's financial statements. It also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

The Company's policy is to recognize interest and penalties that would be assessed in relation to the settlement value of unrecognized tax benefits as a component of income tax expense. The Company has recognized no interest or penalties since the adoption of the accounting guidance related to accounting for uncertainty in income taxes.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations for fiscal years ending before 2015. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carry forward amount.

Earnings per Share

Under our Articles of Incorporation, we may pay dividends on our Class A Common Stock in excess of the dividends we pay on our Class B Common Stock. As a result, we have computed our earnings per share in compliance with the applicable authoritative guidance. This guidance requires companies that have multiple classes of equity securities to use the "two class" or "if converted method" in computing earnings per share.

For our diluted earnings per share calculation, we use the if-converted method. This calculation assumes that all Class B Common Stock is converted into Class A Common Stock. As a result, there are no holders of Class B Common Stock to participate in undistributed earnings. Furthermore, for Class A shares, distributed earnings with respect to Class A and all undistributed earnings are used to calculate diluted earnings per share.

Earnings per share has been presented in accordance with the applicable guidance. We believe that the holders of Class A and Class B Common Stock have equal rights to the Company's undistributed earnings, and that our calculation best expresses economic reality.

The Company had no common stock equivalents issued or outstanding for the three-year period ended July 28, 2018.

Advertising

The Company charges advertising costs when incurred as a component of selling, general and administrative expenses. Advertising expense amounted to approximately $1,018,000, $487,000, and $1,029,000 for fiscal years 2018, 2017, and 2016, respectively.

Shipping and Handling

Shipping and handling costs that are charged to and reimbursed by the customer are recognized as revenues, while the related expenses, including buying, postage, external distribution and warehousing costs incurred by the Company are recorded as components of cost of goods sold in the consolidated statements of operations.

Split-Dollar Life Insurance

The Company is party to a split-dollar arrangement with respect to certain life insurance policies. We record an amount that is to be realized under the split dollar agreement. This amount is the actual premiums paid by the Company or the actual cash surrender value of the policy, whichever is less.

Real Estate Held for Investment

Real estate held for investment is land recorded at cost plus the cost of any improvements. Land is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

2. INVENTORIES

Current costs exceeded the LIFO value of inventories by approximately $748,000 and $814,000 at July 28, 2018 and July 29, 2017, respectively. Year-end inventories valued under the LIFO method were approximately $5,254,000 and $5,907,000 at July 28, 2018 and July 29, 2017, respectively. For fiscal 2017, higher FIFO pricing resulted in an increased LIFO reserve, which decreased net earnings by approximately $62,000, as compared to lower FIFO pricing for fiscal 2018 resulting in a decreased LIFO reserve, which increased net earnings by approximately $47,000.

Inventory reserves applicable to the FIFO inventories totaled approximately $320,000 and $420,000 for fiscal 2018 and fiscal 2017, respectively.

The components of inventory, net of reserves, at each year-end are as follows:

	(In thousands)	
	2018	**2017**
Raw materials	$ 2,174	$ 2,670
Work-in-process	712	966
Finished goods	15,541	14,637
	$ 18,427	$ 18,273

3. PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost. Depreciation for financial reporting purposes is provided using the straight-line method over the estimated useful lives of the assets. Estimated useful lives range from three years for computer equipment to thirty-one and one-half years for buildings. Expenditures for routine maintenance and repairs are charged to expense as incurred.

Property and equipment at July 28, 2018 and July 29, 2017 consisted of the following:

	(In thousands)	
	2018	**2017**
Land and improvements	$ 612	$ 612
Buildings	6,948	6,906
Machinery and equipment	7,433	6,315
Furniture and fixtures	5,369	5,322
	20,362	19,155
Less: Accumulated depreciation	(12,987)	(11,764)
	$ 7,375	$ 7,391

Depreciation expense for fiscal years ended 2018, 2017, and 2016 was approximately $1,234,000, $1,211,000, and $907,000, respectively.

4. MARKETABLE SECURITIES

The components of our marketable securities as of July 28, 2018 and July 29, 2017 are as follows:

	(In thousands)	
	2018	**2017**
Available-for-sale:		
Short term equity securities	$ 2,211	$ 505
Long term equity securities	3,899	3,804
	$ 6,110	$ 4,309

5. NOTES PAYABLE AND LINES OF CREDIT

Lines of Credit

The Company has a $5,000,000 revolving line of credit with a bank. The Company had no outstanding borrowings under this line of credit as of July 28, 2018 and July 29, 2017. This line of credit provides for interest on outstanding balances to be paid monthly at the prime rate less 1.0%. This line of credit expires in January 2019 and is secured by the inventory and accounts receivable of the Company's western and work boot subsidiary.

The Company has an additional $1,750,000 line of credit with a bank. This line is restricted to 100% of the outstanding accounts receivable due from the U.S. Government. There were no outstanding borrowings under this line of credit as of July 28, 2018 and July 29, 2017. The line of credit expires in January 2019 and provides for interest on outstanding balances to be paid monthly at the prime rate.

6. EMPLOYEE BENEFIT PLANS

The Company's employee benefit program consists of an employee stock ownership plan, a 401-K retirement plan, a cash bonus program, incentive awards, and other specified employee benefits as approved by the Board of Directors.

The employee stock ownership plan (ESOP) covers substantially all employees. Its principal investments include shares of Class A Common Stock and Class B Common Stock of the Company and collective funds consisting of short-term cash, fixed-income, and equity investments. There have been no contributions to the ESOP in fiscal years 2018, 2017 or 2016.

The Company has a 401-K retirement plan, which covers substantially all employees. Employees can contribute up to 25% of their annual salary to the plan. At its sole discretion, the Board of Directors determines the amount and timing of any Company matching contribution. The Company's contributions were approximately $266,000, $308,000, and $292,000, for the fiscal years ended 2018, 2017, and 2016, respectively.

Employee benefit program expense amounted to approximately $679,000, $1,439,000, and $1,369,000, for the fiscal years ended 2018, 2017 and 2016, respectively.

7. INCOME TAXES

Significant components of the provision for income taxes are as follows (in thousands):

	2018	2017	2016
Current expense			
Federal	$ 383	$ 2,549	$ 1,706
State	110	149	156
	493	2,698	1,862
Deferred expense			
Federal	33	338	808
State	5	60	143
	$ 531	$ 3,096	$ 2,813

The components of the provision (benefit) for deferred income taxes are as follows (in thousands):

	2018	2017	2016
Depreciation	$ (266)	$ (109)	$ 758
Accrued employee benefits	313	2	204
Allowances for doubtful accounts	54	64	114
Allowance for sales returns	89	125	20
Inventory	230	166	6
State net operating loss carry forward	5	106	(54)
Economic Price Adjustment Claim	22	4	-
Amortization	(283)	(1)	71
Prepaid Expenses	(53)	53	(98)
Self Insurance Reserve	57	9	(70)
Like Kind Exchange	(130)	-	-
Other	-	(21)	-
Provision for deferred income taxes	$ 38	$ 398	$ 951

Deferred tax liabilities and assets at each year-end are as follows (in thousands):

	2018	2017
Amortization	$ (602)	$ (885)
Gain on Like Kind Exchange	(240)	(370)
Depreciation	(847)	(1,113)
Prepaid Expenses	-	(53)
Noncurrent deferred tax liabilities	(1,689)	(2,421)
State net operating loss carry forward	100	105
Self Insurance	105	162
Accrued employee benefits	99	412
Allowances for doubtful accounts	167	221
Allowance for sales returns	118	207
Inventory	428	658
Economic Price Adjustment Claim	42	64
Unrealized (Gain)/Loss	9	3
Noncurrent deferred tax assets	1,068	1,832
Net noncurrent deferred tax liabilities	$ (621)	$ (589)

State net operating loss carry forwards of $4.0 million will begin to expire in fiscal 2024.

The reconciliation of income tax computed at the U.S. federal statutory tax rate to actual income tax expense are (in thousands):

	2018		2017		2016	
	Amount	Percent	Amount	Percent	Amount	Percent
Tax at U.S. statutory rate	$ 722	26.5 %	$2,781	34.0 %	$2,552	34.0 %
State income taxes, net of federal tax benefit	76	2.8 %	138	1.7 %	197	2.6 %
Tax adjustments	160	5.9 %	139	1.7 %	154	2.1 %
Impact of tax reform	(390)	(14.3) %	-		-	
Other – net	(37)	(1.4) %	38	0.5 %	(90)	(1.2) %
	$ 531	19.5 %	$3,096	37.9 %	$2,813	37.5 %

The items included as "other-net" relate to permanent differences, adjustment for non tax consolidated entities, and prior year tax provision to return adjustments.

On December 22, 2017, the United States enacted tax reform legislation commonly known as the H.R.1, ("the Act"), resulting in significant modifications to existing law. The legislation reduced the U.S. corporate income tax rate from 35% to 21%. The Company has completed the accounting for the effects of the Act during the year ending July 28, 2018. As a result, our financial statements for the year ended July 28, 2018, include a one-time tax benefit of $390. This impact was primarily due to the remeasurement of deferred tax assets and liabilities from 35% to 21% totaling $390.

Total income tax payments during fiscal years 2018, 2017 and 2016 were approximately $1,410,000, $2,104,000, and $2,918,000, respectively.

The Company follows the applicable authoritative guidance related to accounting for uncertainty in income tax reporting. As of July 28, 2018, management has concluded no related liability is necessary.

8. COMMITMENTS AND CONTINGENCIES

Lease Agreements

The Company leases certain offices and equipment under non-cancelable operating leases. Rental expenses on all operating leases were $664,000, $725,000, and $559,000, for fiscal years ended 2018, 2017, and 2016, respectively. The future non-cancelable lease payments as of July 28, 2018 are as follows:

	2019	2020	2021	2022	2023
Lease Payments	$633,000	$612,000	$584,000	$584,000	$584,000

The Company leases approximately 34,000 square feet of office and warehouse space to Toshiba Business Solutions, Inc. The original lease and subsequent amendments covered a base year period and additional periods through August 31, 2016. In February 2016, the lease was amended to cover a three-year period beginning on September 1, 2016. These lease and facility charge payments are reported as a component of "Other Income". The future minimum lease and facility charge payments are as follows:

	2019
Lease Payments	$50,000
Facility Charges	$72,697

Concentrations

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments and receivables. The Company maintains substantially all of its cash and certificates of deposits with a financial institution in amounts that are in excess of the federally insured limits, which totaled approximately $28 million, $28 million, and $16 million, for fiscal 2018, 2017, and 2016, respectively. Management performs periodic evaluations of the relative credit standing of this financial institution.

Concentrations of credit risk with respect to receivables are minimal due to the large number of entities comprising the Company's customer base and their dispersion across many different industries. The Company does not require collateral on trade accounts receivable. As of July 28, 2018 and July 29, 2017, twenty-one customers accounted for 60% and 62% of accounts receivable, respectively.

Synthetic rubber used in our vulcanizing military boot operation is currently available and purchased from the only domestic supplier known to us. Synthetic rubber is available from foreign suppliers; however, an exemption would be required from the U.S. Government to purchase synthetic rubber in the foreign market. The Vibram rubber specified outsoles are a registered product available only from Vibram USA and we depend on their ability to supply our needs. This supplier provided Vibram rubber outsoles for approximately $2.0 million and $4.3 million at July 28, 2018 and July 29, 2017 respectively.

Sales to the U.S. Government amounted to 24%, 38%, and 28%, of total consolidated net revenues for fiscal years ended 2018, 2017, and 2016, respectively. Under the terms of sale to the U.S. Government, the negotiated contract prices of combat boots are subject to renegotiation if certain conditions are present. Management does not currently expect renegotiation, if any, to have a material adverse effect on the Company's consolidated financial position or results of operations.

9. SHAREHOLDERS' EQUITY

Common Stock

The Company's Bylaws provide for seven directors, two of whom are elected by the holders of the Class A Common Stock voting as a separate class, and five of whom are elected by the holders of the Class B Common Stock voting as a separate class. On all other matters (except matters required by law or the Company's Certificate of Incorporation or Bylaws to be approved by a different vote), the holders of Class A Common Stock and Class B Common Stock vote together as a single class with each share of Class A Common Stock entitled to one-tenth vote and each share of Class B Common Stock entitled to one vote. Each share of Class B Common Stock can be converted to Class A Common Stock on a share for share basis. All dividends paid on Class B Common Stock must also be paid on Class A Common Stock in an equal amount.

The Company has adopted the McRae Industries, Inc. 1998 Incentive Equity Plan (the Plan). Under the Plan, 100,000 shares of the Company's Class A Common Stock are reserved for issuance to certain key employees of the Company. At July 28, 2018, there were 100,000 shares available for future grants under the Plan.

The common stock is currently quoted in the Pink Sheets and stockholders are able to trade their shares in the over-the-counter markets or private transactions.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

FASB ASC 820 "Fair Value Measurements and Disclosures" defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date (that is, an exit price). The exit price is based on the amount that the holder of the asset or liability would receive or need to pay in an actual transaction (or in a hypothetical transaction if an actual transaction does not exist) at the measurement date. In some circumstances, the entry and exit price may be the same; however, they are conceptually different. The accounting standards also establish a three-level hierarchy that prioritizes the inputs used in fair value measurements. The hierarchy consists of three broad levels as follows:

Level 1 – Quoted market prices in active markets for identical assets or liabilities;
Level 2 – Observable inputs other than quoted prices within Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data; and
Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These include certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The fair values of the Company's available for sale securities are determined using quoted market prices in active markets for identical assets or liabilities, which are classified as Level 1 inputs.

The following table presents those assets and liabilities that are measured at fair value as of July 28, 2018 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Mutual Funds	$ 6,110	–	–	$ 6,110

The following table presents those assets and liabilities that are measured at fair value as of July 29, 2017 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Mutual Funds	$ 4,309	–	–	$ 4,309

The fair value of our cash and cash equivalents, accounts and notes receivable, accounts payable, and accrued liabilities approximate their carrying values due to their liquid nature.

The amount due from Split-Dollar Life Insurance policies represents the value of the Company's rights under split-dollar arrangements. Under these arrangements, the Company is entitled to be repaid cumulative premiums paid, or if less, the net cash surrender value of the policies.

11. RELATED PARTY TRANSACTIONS

The Company leases administrative and sales office space in Clarksville, Tennessee for the western boot business from the President of Dan Post Boot Company. The annual rent is approximately $105,000.

12. SUBSEQUENT EVENTS

On August 29, 2018, the Company declared a cash dividend of $.63 per share on its Class A and Class B Common Stock payable on September 26, 2018 to shareholders of record on September 12, 2018.

Subsequent events have been evaluated through October 30, 2018, which is the date the financial statements were available to be issued.

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EXECUTIVE OFFICERS & DIRECTORS

Executive Officers

D. Gary McRae
Chairman of the Board, President, Chief Executive Officer and Treasurer

James W. McRae
Vice-President and Secretary

Charles E. Covatch
President, McRae Footwear

Directors

D. Gary McRae
Chairman of the Board, President, Chief Executive Officer and Treasurer

James W. McRae
Vice-President and Secretary

Victor A. Karam
Former President, McRae Footwear

Marvin G. Kiser, Sr.
Former Vice-President of Finance

Hilton J. Cochran, Jr.*
Executive Director
Peacehaven Community Farm

Brady W. Dickson*
Consultant

Branson B. McRae
Compliance and Operations Manager, Dan Post Boot Co.

*Members of Audit and Compensation Committees

SHAREHOLDER INFORMATION

Shareholders

Requests for interim and annual reports or more information about the Company should be directed to:

Office of the Secretary
McRae Industries, Inc.
P. O. Box 1239
Mount Gilead, North Carolina 27306

Stock

McRae's common stock is traded on the Pink Sheets (MCRAA and MCRAB).

Transfer Agent, Registrar, and Dividend Disbursing Agent

American Stock Transfer & Trust Company
6201 15th Ave
Brooklyn, NY 11219

Annual Meeting

Thursday, December 20, 2018
Corporate Offices
400 North Main Street
Mount Gilead, North Carolina 27306

Independent Auditors

Grant Thornton LLP
201 South College St.
Suite 2500
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GENERAL COUNSEL

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